No. 95-1918

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

STATE OF ARKANSAS, PETITIONER

v.

FARM CREDIT SERVICES OF CENTRAL ARKANSAS, PCA; FARM CREDIT SERVICES OF WESTERN ARKANSAS, PCA; EASTERN ARKANSAS PRODUCTION CREDIT ASSOCIATION; and DELTAPRODUCTION CREDIT ASSOCIATION

RESPONDENTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE PETITIONER

MARTHA G. HUNT, Bar No. 87090
Attorney, Revenue Legal Counsel
Arkansas Department of
Finance and Administration
7th and Wolfe Streets
P.O. Box 1272, Room 209
Little Rock, Arkansas 72203
(501) 682-7030

Counsel of Record for Petitioner

PARAGON/PROGRESSIVE PRINTING, 1000 E. 2nd Street, Little Rock, AR 72201 (501) 375-1281

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QUESTIONS PRESENTED

Whether the case should have been dismissed by the district court for lack of subject matter jurisdiction, in light of the Tax Injunction Act, 28 U.S.C. Section 1341.

Whether Production Credit Associations are exempt from taxation by the State of Arkansas either as federal instrumentalities or by 12 U.S.C. § 2077.

LIST OF PARTIES

The parties to this proceeding are as follows: The Petitioner is the State of Arkansas. The Respondents are four Production Credit Associations chartered by the Farm Credit Association, including Farm Credit Services of Central Arkansas, PCA; Farm Credit Services of Western Arkansas, PCA; Eastern Arkansas Production Credit Association; and Delta Production Credit Association.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES: Page

STATUTES AND REGULATIONS Page

MISCELLANEOUS: Page

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eighth Circuit (J.A. 139) is reported at 76 F.3d 961 (1996). The Order of the United States District Court of the Eastern District of Arkansas, Western Division, (J.A. 73) is unreported.

JURISDICTION

The Opinion of the United States Court of Appeals for the Eighth Circuit was entered on February 23, 1996. The petition for a writ of certiorari was filed on May 22, 1996, and was granted on January 17, 1997. The jurisdiction of this Court rests on 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS INVOLVED

Article VI, Clause 2 of the United States Constitution provides in pertinent part:

This Constitution, and the laws of the United States which shall be made in pursuance thereof . . . shall be the supreme law of the land . . .

STATUTORY PROVISIONS INVOLVED

28 U.S.C. § 1341 provides:

The district courts shall not enjoin, suspend, or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.

12 U.S.C. § 2077 provides:

Each production credit association and its obligations are instrumentalities of the United States and as such any and all notes, debentures, and other obligations issued by such associations shall be exempt, both as to principal and interest, from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or any State, territorial, or local taxing authority, except that interest on such obligations shall be subject to Federal income taxation in the hands of the holder.

STATEMENT

Respondents, four Production Credit Associations (PCAs) are cooperative credit institutions chartered by the Farm Credit Administration to provide financial services to borrowers, primarily for agricultural purposes, rural housing, and farm related purposes. Each of the PCAs is located in Arkansas. The stock of the corporations is owned by the members who are the borrowers. The PCAs filed the appropriate returns and paid corporate income tax and sales tax to the State of Arkansas from the time they were chartered.[1]

In 1994, the four PCAs requested that the State of Arkansas, through the Commissioner of Revenues, recognize that they, as federal instrumentalities, are exempt from state income and sales tax, and stated that as a result of the exemption, the taxes paid by the PCAs in 1991, 1992, 1993 and 1994 had been paid in error. J.A. 5-6.

The Department denied the PCAs' request for an exemption from state taxation based upon federal statutory authority, legislative history, and the structure and function of PCAs which more closely parallel that of private corporations than of federal instrumentalities. The Department also denied the PCAs' request for a refund of the taxes paid by the PCAs in 1991 through 1994.

In June 1994, the PCAs instituted this action in the United States District Court for the Eastern District of Arkansas seeking a declaratory judgment that, as federal instrumentalities, they were exempt from state and local taxes, including income tax and gross receipts (sales) tax, and an injunction against the imposition or assessment of such taxes by the State

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[1] Farm Credit Services of Central Arkansas, PCA began paying state sales and income taxes in 1991. The other three PCAs apparently began paying at approximately the same time. Each likely paid state taxes prior to that time under the name of a predecessor organization. J.A. 6.

of Arkansas. J.A. 1. The District Court's jurisdiction was invoked pursuant to 28 U.S.C. § 1331 and Article Six, Clause Two of the Constitution of the United States. J.A. 2.

The PCAs did not dispute in the district court that Arkansas' state law remedy was plain, speedy and efficient. Conversely, in August 1994, the PCAs filed a suit in the Chancery Court of Pulaski County, Arkansas for refund of the taxes pursuant to Ark. Code Ann. § 26-18-507, which provides judicial relief in chancery court from the denial of a refund request.[2]

Arkansas filed a motion to dismiss the declaratory judgment action, alleging, in part, that the suit was barred by the Tax Injunction Act. J.A. 15. In December 1994, the PCAs filed a motion for summary judgment alleging that the constitutional doctrine of the implied immunity of federal instrumentalities from state taxation immunized the PCAs and that Congress had not expressly waived the immunity of PCAs. J.A. 28.

On March 7, 1995, the district court entered its order which denied Arkansas' motion to dismiss and granted the PCAs' motion for summary judgment. The district court held that the Tax Injunction Act did not apply, citing *Department of Employment v. United States*, 385 U.S. 355 (1966), a suit filed by the United States rather than by the instrumentality on its own behalf. The court held that PCAs are federal instrumentalities from which arises an implied immunity from state taxation. The court further held that this immunity must be expressly waived by Congress and that the court did not find such express waiver. J.A. 73-76.

Arkansas appealed the district court's decision to the United States Court of Appeals for the Eighth Circuit. J.A. 77.

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[2] The PCAs filed a motion for summary judgment in the state court case following the entry of the Eighth Circuit opinion holding PCAs exempt from all state taxation. this motion was denied pending the outcome of this case; however, the order denying the motion has apparently not yet been entered.

The Court of Appeals for the Eighth Circuit affirmed the decision of the district court, on February 23, 1996. J.A. 139-. The court held that, as federal instrumentalities, PCAs are immune from all taxation, regardless of their structure and function. J.A. 142 The court further held that any waiver of this immunity must be expressly stated by Congress and that nothing in 12 U.S.C. § 2077 indicates the intent of Congress to waive the immunity. J.A. 144-145. Judge Loken dissented, finding that the decision was contrary to the principle of deference to Congress. J.A. 146. He asserted that the court's opinion construed a technical amendment, which repealed an express exemption no longer available to any PCA, as granting a more extensive implied exemption from state taxation to PCAs. J.A.151.

Arkansas filed a petition for a writ of certiorari seeking review of the decision of the Court of Appeals for the Eighth Circuit which held PCAs immune to state taxation as federal instrumentalities. This Court granted certiorari, requesting that the parties brief the additional question of whether the district court should have dismissed the case for lack of subject matter jurisdiction, in light of the Tax Injunction Act, 28 U.S.C. § 1341.

SUMMARY OF ARGUMENT

The Tax Injunction Act, 28 U.S.C. § 1341, was enacted to provide freedom from federal court interference with state taxation by providing for state rather than federal court resolution of disputes between a state and a taxpayer over state taxation, provided state law affords a "plain, speedy and efficient" remedy to the taxpayer in state court.

The United States is exempt from the provisions of the Tax Injunction Act. *Department of Employment v. United States*, 385 U.S. 355 (1966). The Act itself does not specifically exempt the United States. However, courts have created this judicial exemption based upon the common law principle that the sovereign is not subject to restrictive legislative enactments,

unless by its terms, the enactment so provides. Courts have also considered the inability of the United States to appropriate funds to pay the tax under protest, as required by most state law measures, to be an additional rationale for exempting the United States from the requirement that it litigate state tax law disputes in state court.See generally, *United States v. Livingston,* 179 F. Supp. 9(E.D.S.C. 1959) aff'd without opinion, 364 U.S. 281 (1960).

The judicially created exemption for the United States was considered to apply to the United States when it asserted that its interests were at stake. Courts allowed the United States access to district court to challenge state taxation not only on its own behalf, but also on behalf of a federal instrumentality, and on behalf of a third party with whom the government has a relationship. Courts have generally been more reluctant to find that the Tax Injunction Act did not bar jurisdiction when various federal instrumentalities attempted, on their own behalf and without the assistance of the United States, to challenge state taxation in district court. However, Indian tribes, federal reserve banks, and the FDIC, among others, have been permitted to proceed in district court on their own behalf. In the majority of these cases, the court employed an additional jurisdictional basis for holding that the Tax Injunction Act did not bar the action. Some of those bases included a specific statute providing for federal court jurisdiction over the instrumentality, *Moe v. Salish & Kootenai Tribes,* 425 U.S. 463 (1976), or the important governmental functions performed by the instrumentality. *Federal Reserve Bank of Boston v. Comm. of Corporations,* 499 F.2d 60 (CA1 1974).

Production Credit Associations do not qualify for the exemption afforded the United States. The United States did not appear in this proceeding to assert that its interests, as carried out through PCAs, was at stake. Congress did not grant PCAs access to federal court statutorily. PCAs are not "governmental" corporations; their structure, form, and function much more closely parallel that of private corporations than of "arms of

the Government." *Department of Employment v. United States* 385 U.S. 355 (1966).

For the foregoing reasons, the District Court should have held that jurisdiction was barred by the Tax Injunction Act and dismissed the case.

For many of the same reasons, the lower court's decision that the doctrine of implied immunity of federal instrumentalities from state taxation automatically exempts PCAs from taxation is erroneous. This doctrine had its origins in *McCulloch v. Maryland,* 17 U.S. (4 Wheat) 316 (1819), construing the Supremacy Clause. Originally, based upon principles of sovereignty, it exempted Federal and state governments from the ability of the other to tax. The doctrine originally enjoyed a broad application, followed by a more restrictive interpretation.

Although it has been some time since this Court has specifically considered the issue of whether an entity named a federal instrumentality by Congress is exempt from state taxation, this Court's precedents, in considering the issue in relation to third parties contracting with the government, suggest that in order for the immunity to apply, the instrumentality must "stand in the Government's shoes." *United States v. New Mexico,* 455 U.S. 720, 736 (1982). PCAs, as previously explained, are not sufficiently governmental to meet this standard.

Additionally, Congress acted from the time PCAs were created to provide them with an express exemption from taxation. Originally, the exemption provided broad immunity from both state and federal taxation, excepting only their real property from the exemption. However, the statute also specifically waived the broad exemption at the time PCAs became privately owned.

In 1985, in a significant amendment to the Farm Credit Act, Congress amended the PCA taxation statute, by deleting both the express exemption and the waiver of exemption, leaving the language in the present statute. Legislative history indicates that this amendment was part of a technical correction to

remove references to the Governor, a position which was abolished by the amendments.

Although the present statute exempts the notes, debentures, and obligations issued by PCAs, it does not confer the broad immunity from state taxation construed by the lower courts.

ARGUMENT

1. The District Court should have dismissed this case, because the Tax Injunction Act, 28 U.S.C. § 1341, deprived the district court of jurisdiction over the suit filed by four Production Credit Associations for a declaratory judgment that they were exempt from taxation by the State of Arkansas.

The Tax Injunction Act, 28 U.S.C. § 1341 provides:

> The district courts shall not enjoin, suspend, or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.

The Tax Injunction Act deprives federal courts of jurisdiction to issue declaratory relief holding state tax laws unconstitutional as well as to enjoin the collection of state taxes when state law provides a plain, speedy and efficient remedy. *California v. Grace Brethren Church*, 457 U.S. 393, 411 (1982).

a. The State of Arkansas provides a taxpayer with an opportunity for a full hearing and judicial determination at which time any constitutional objections to a state tax may be raised.

Arkansas law provides a refund procedure for a taxpayer who paid a state tax through error of fact, computation, or mistake of law. The tax is refunded if the Department of Finance and Administration determines, based upon an amended return or a

verified claim for refund filed by the taxpayer, that the tax was erroneously paid. The taxpayer may file suit in chancery court if the director denies the refund request, in whole or in part, or fails to timely render a decision on the refund request. Ark. Code Ann. § 26-18-507.[3]

Arkansas law also provides for judicial relief in chancery court from an administrative decision adverse to the taxpayer who contests an assessment of state tax. The taxpayer may file suit in chancery court after either paying the tax under protest or filing a bond in double the amount of the deficiency. Ark. Code Ann. § 26-18-406.[4]

Any refund due the taxpayer is paid with interest at the rate of ten percent (10%) per annum. Ark. Code Ann. § 26-18-508(3).

The Arkansas Supreme Court has held that the State's sovereign immunity has been waived by Ark. Code Ann. § 26-18-507 which allows a taxpayer to sue the State upon the State's denial of, or failure to act upon, a claim for refund. *State v. Staton*, 325 Ark. 341, 344, 925 S.W.2d 418 (1996) (substituted opinion on rehearing). The Arkansas Supreme Court has also held that Ark. Code Ann. § 26-18-406 provides the exclusive method for challenging an assessment of tax deficiency. *Taber v. Pledger*, 302 Ark. 484, 791 S.W.2d 361, 363 (1990), cert. denied 498 U.S. 967 (1990).

Arkansas' state law remedy provides a taxpayer with the "full hearing and judicial determination" held to provide a "plain, speedy and efficient" state law remedy as required by *Rosewell v. LaSalle National Bank*, 450 U.S. 503, 514-15 (1981).

The PCAs did not assert in the district court that Arkansas lacked a plain, speedy and efficient state law remedy. Conversely, shortly after the PCAs filed this suit in district court,

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[3] Ark. Code Ann. § 26-18-507 is printed in its entirety at Appendix A.

[4] Ark. Code Ann. §26-18-406 is printed at Appendix B.

they filed suit in state court for refund of state income and gross receipts (sales) taxes, citing Ark. Code Ann. § 26-18-507 as the basis for their cause of action.[5] In their response to Defendant's allegation that the district court lacked jurisdiction due to the Tax Injunction Act, J.A. 20, the PCAs cited federal court decisions which had conferred jurisdiction over federal instrumentalities suing on their own behalf, J.A. 26, and did not allege that Arkansas' state law remedy was not adequate.

b. Soon after the enactment of the predecessor to the Tax Injunction Act, federal courts created an exemption to the Tax Injunction Act for the United States when it asserts that its interests are at stake.

In *City of Springfield v. United States*, 99 F.2d 860 (CA 1 1938) the Circuit Court of Appeals for the First Circuit held that 28 U.S.C.A. § 41(1)[6] did not bar federal court jurisdiction of a suit brought by the United States to enjoin collection of a real property tax imposed by a Massachusetts city against the United States. 99 F.2d at 862. The court held that the statute did not apply to the United States, based in part on the conclusion that a remedy which required an appropriation as a condition precedent to relief was not adequate as to the United States, since it could not constitutionally appropriate money to pay the tax and then seek a refund. *Id.*

Following an amendment which codified the statute at 28

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[5] The Chancery Court of Pulaski County, Arkansas denied the PCAs' motion for summary judgment pending the outcome of this case.

[6] 50 Stat. 728, enacted on August 21, 1937, provided that "no district court shall have jurisdiction of any suit to enjoin the collection of any tax imposed by or pursuant to the laws of any state where a plain, speedy and efficient remedy may be had at law or in equity in the courts of that state."

U.S.C. § 1341 with insignificant changes in the language, the Second Circuit held that § 1341's bar to jurisdiction did not apply to the United States, based upon legislative history and because the section did not specifically mention the United States.[7] *United States v. Woodworth*, 170 F.2d 1019, 1020 (CA 2 1948)

The reasons enunciated in *City of Springfield* and in *Woodworth* for exempting the United States from the jurisdictional bar of the Tax Injunction Act were approved in *United States v. Livingston*, 179 F.Supp. 9, 12 (E.D.S.C. 1959), aff'd without opinion, 364 U.S. 281 (1960). In *Livingston*, unlike *Springfield* and *Woodworth*, which had involved a tax on real property owned by the government, the action was brought by the United States to enjoin collection of South Carolina sales and use taxes from a private corporation which contracted with the Atomic Energy Commission.

The Tenth Circuit, employing similar reasoning to that in *Livingston*, reversed the district's court's dismissal and allowed the United States and Phillips Petroleum Company to proceed in a federal court action for a declaratory judgment and for a refund of taxes paid under protest by Phillips, which processed and sold uranium to the Atomic Energy Commission. *United States v. Bureau of Revenue of State of New Mexico*, 291 F.2d 677 (CA10 1961).

c. Federal courts have continued to recognize the exemp-

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[7] The Court cited *United States v. United Mine Workers*, 330 U.S. 358, 272 (1947) for the proposition that had Congress intended the United States to be subject to the statute, it would have expressly declared that intent in the statute. The *United Mine Workers* opinion gives due consideration to an old rule and precedent that the sovereign will not be deemed subject to a restrictive statute "without express words to that effect,...." 330 U.S. at 272.

tion from the Tax Injunction Act for the United States but have rarely extended the exemption to federal instrumentalities suing on their own behalf, absent other reasons such as a separate statutory basis for jurisdiction.

This Court, agreeing with lower court authority, and based upon the legislative history of the Tax Injunction Act, held that the Act did not prevent the United States from filing suit on behalf of the Red Cross in federal court for an injunction against state taxation, which the Court held was sufficiently governmental to be a tax immune federal instrumentality. *United States v. Department of Employment*, 385 U.S. 355, 357-58 (1966).[8]

In one of the first cases allowing a federal instrumentality to proceed in district court without the United States as a party, the Ninth Circuit held that the district court had jurisdiction of an action brought by an Indian tribe, independently of the United States, to enjoin the assessment, levy and collection of state possessory interest tax. *Agua Caliente Band of Mission Indians v. County of Riverside*, 442 F.2d 1184, 1186 (CA9 1971), cert. denied 405 U.S. 933 (1972). The court analyzed, in announcing the "co-plaintiff" exemption, that the reasons for allowing an exemption from the Tax Injunction Act for the United States were equally persuasive when the exemption was sought by Indians, the beneficial owner of lands held in trust by the

[8] Almost twenty years after *Department of Employment*, the United States District Court for the Western District of Michigan recognized its continuing validity in *United States v. State of Michigan*, 851 F.2d 803 (CA6 1988) in a suit brought by the United States seeking a declaratory judgment that federal credit unions are immune from state sales taxes as federal instrumentalities.

United States, which Indian lands were federal instrumentalities. 442 F.2d at 1185-86.[9]

The First Circuit refused to extend the holding in *Agua Caliente* to "all situations where an instrumentality brings a suit ... independently of the United States," concluding that the instrumentality in *Agua Caliente*, an Indian tribe, occupied a "unique place in federal law." *United States v. State Tax Commission*, 481 F.2d 963, 975 (CA1 1973). The district court allowed six federal savings and loan associations to intervene, in a suit filed by the United States on behalf of the Federal Home Loan Bank Board seeking declaratory relief against the deposits tax, and to assert an additional claim not asserted by the United States for declaratory relief against the income tax. The First Circuit held that the United States' presence in challenging the deposits tax did not grant jurisdiction to the intervenors, recognized by the Court as federal instrumentalities, to challenge the income tax, not challenged by the United States. 481 F.2d at 975.

The following year, the First Circuit reached a different result with respect to a different federal instrumentality, a federal reserve bank. *Federal Reserve Bank of Boston v. Commissioner of Corporations and Taxation*, 499 F.2d 60 (CA1 1974). The Court carefully considered the structure and governmental functions of federal reserve banks and found that as "fiscal arms of the federal government,"[10] they should be allowed to pro-

[9] The Ninth Circuit applied the co-plaintiff instrumentality exemption to the jurisdictional bar of 28 U.S.C. § 1341 to hold that the district court had jurisdiction over challenges to state taxation brought by members of Indian tribes. *Moses v. Kinnear*, 490 F. 2d 21 (CA9 1973).

[10] Some of the factors which the Court considered relevant were the lack of profit to shareholders, the absence of commercial banking services, their function as depositories for money held in the United States Treasury and service to the Treasury, as

ceed in federal court without a "symbolic joinder by the United States." In so holding, the court recognized that, rather than adopting a bright line test for exemption of federal instrumentalities from the Tax Injunction Act, it was advocating analysis, instrumentality by instrumentality, of the instrumentality's governmental role, as well as analysis of relevant legislation affecting federal court jurisdiction of the instrumentality. 499 F.2d at 64.

This Court upheld the decision of the District Court for the District of Montana holding that jurisdiction over suits brought by the Salish and Kootenai Tribes attacking cigarette sales taxes and personal property taxes was not barred by the Tax Injunction Act. *Moe v. Salish & Kootenai Tribes*, 425 U.S. 463, 475 (1976). The district court had based its finding of jurisdiction, in part, on an expanded version of the instrumentality doctrine,[11] as well as a statute, 28 U.S.C. § 1362, providing for federal court jurisdiction over all actions brought by Indian tribes arising under the Constitution, laws, or treaties of the United States. This Court examined the legislative history of § 1362 to determine whether § 1362 provided an exemption from the provisions of § 1341, and concluded that § 1362 allowed Indian tribes suing under its provisions to proceed as would the United States appearing in their behalf. The exemption from § 1341 afforded to the United States would thus accrue to Indian tribes under § 1362. Jurisdiction was upheld based upon § 1362 rather than upon the district court's expanded version of the instrumentality doctrine. 425 U.S. at 472-474.

The jurisdictional analysis of *Moe* was employed by the District Court for the District of Connecticut in holding that a suit by fiduciaries of the Railroad Employees National Dental Plan to enjoin a tax which violated ERISA was not barred by the Tax Injunction Act. *National Carriers' Conference Committee v. Heffernan*, 440 F.Supp. 1280 (D.C.D.Conn. 1977). The district court held that because the United States could have brought the suit, and a specific jurisdictional statute contained in ERISA allowed a private plaintiff to sue to enjoin violations of ERISA on the same basis as the Secretary of Labor, jurisdiction was not barred. 440 F. Supp. at 1284.[12]

The Ninth Circuit, which had previously announced the co-plaintiff exemption in *Agua Caliente*, held that the district court did not have jurisdiction over an action challenging state taxation brought by a city public housing agency created pursuant to federal law, in the absence of the United States as a party. *Housing Authority of Seattle v. State of Washington*, 629 F.2d 1307 (CA9 1980). The Court reviewed the First Circuit's decision in *State Tax Commission*, that the Tax Injunction Act barred federal savings and loan associations from suing on their own behalf in federal court, as subsequently modified by its decision allowing a federal reserve bank to sue on its own behalf in *Federal Reserve Bank*. Without deciding whether it agreed with the First Circuit that there are federal instrumentalities entitled to proceed without the United States, the court held that the public housing agencies attempting to claim the exemption were not sufficiently integrated into the structure of the government to allow them the benefit of the exemption.

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well as a special jurisdictional stature for federal reserve banks, 12 U.S.C. § 632. 499 F.2d at 62-63.

[11] In its opinion, the district court indicated that federal court jurisdiction was not barred by § 1341 over "persons or entities in which the United States has a real and significant interest." 425 U.S. at 471.

[12] In a subsequent decision, the Supreme Court indicated in dicta that in order for the ERISA jurisdictional statute to operate as an exception to the Tax Injuction Act, the party claiming jurisdiction thereunder can prove that the state remedy is not speedy or efficient, or that the jurisdictional statue was intended to be an exception to the Act. *Franchise Tax Board v. Construction Laborers Vacation Trust*, 463 U.S. 1, 20 (1983).

629 F.2d at 1311-12. The court further recognized that the *Moe* decision clarified the exemption from § 1341 for Indian tribes as arising from the jurisdictional grant of 28 U.S.C. § 1362, rather than from the federal instrumentality doctrine. As a result, the co-plaintiff exemption of *Agua Caliente* and *Moses* was no longer applicable to parties other than Indian tribes. 629 F.2d 1312-13.

Although the district court had held it had jurisdiction and the issue was not presented on appeal, the Fifth Circuit briefly addressed the issue of why jurisdiction was not barred in a challenge of city special assessments by the FDIC. *Federal Deposit Insurance Corp. v. City of New Iberia*, 921 F.2d 610 (CA5 1991). Citing *Department of Employment* and *Federal Reserve Bank*, the Court held that FSLIC and FDIC are federal agencies exempt from § 1341.[13]

The Second Circuit, confronted with the same issue and the same instrumentality shortly after the *New Iberia* decision, affirmed the district court's decision that the Tax Injunction Act barred federal court jurisdiction over a suit brought by the FDIC. *Federal Deposit Insurance Corporation v. State of New York*, 928 F.2d 56 (CA2 1991). The court found that the FDIC's suit was intended to protect commercial banks, against whom the taxes had been assessed, rather than the federal government, and that the effect of the State tax assessments on the federal government would be minimal. The FDIC argued, in reliance on *Moe*, that the federal instrumentality exemption could apply even when the instrumentality was not the entity being taxed. The court refused to read *Moe* so broadly, finding no "trustee" relationship between the FDIC and commercial banks like that

[13] The court also cited 12 U.S.C. § 1730 (k) (1), a statue then in effect but subsequently repealed by Pub. L. 101-73, Title IV, § 407, Aug. 9, 1989, 193 Stat. 363, which provided for original jurisdiction in district court, as well as a removal provision, for all civil actions in which FSLIC was a party.

between the Tribes and the United States in *Moe*. 928 F.2d at 60. In holding that the FDIC could not invoke the federal instrumentality exemption, the court stated that to hold otherwise would "be starting down a road leading toward use of the exception by any taxpayer whose operations were affected by congressional regulation. Taking this path would result in the erosion of the exception altogether." 928 F.2d at 61.

The First Circuit, in recognition of its precedent of examining the governmental role and relevant legislation relating to an instrumentality attempting to claim the exemption, held that the FDIC, as receiver for an insolvent bank, did not qualify for the exemption. *Bank of New England Old Colony, N.A. v. Clark*, 986 F.2d 600 (CA1 1993). The FDIC, as receiver for the Bank, removed a tax dispute from state court to district court pursuant to the FDIC removal statute,[14] and the District Court remanded on the basis that § 1341 required the District Court to abstain. The First Circuit, disagreeing that abstention was the correct basis for the remand, reviewed the decisions of the Second Circuit in *New York* and the Fifth Circuit in *New Iberia*, which disagreed as to whether the FDIC was entitled to the benefit of the federal instrumentality exemption from the Tax Injunction Act.[15] Based upon the FDIC's role as receiver for a private bank and the absence of statutory language granting

[14] 12 U.S.C. § 1819 (b) (2) (B) provides that the FDIC may remove any suit from a State court to district court.

[15] The Court also reconized that the District Court for the District of Colorado held that FDIC is not a federal instrumentality for purposes of the Tax Injuction Act. *Pima Financial Service Corporation v. Intermountain Home Systems*, 786 F. Supp. 1551, 1560 (D. Colo. 1992).

FDIC agency status for purposes other than 28 U.S.C. § 1345[16], the court held that the FDIC was not entitled to the federal instrumentality exemption. The court then found it necessary to resolve what it perceived to be a jurisdictional conflict between the removal statute and the Tax Injunction Act. Finding no clear evidence in legislative history that the removal statute was intended as an exception to the Tax Injunction Act, the Court affirmed the District Court's remand of the case to State court. 986 F.2d at 604.

The Third Circuit, agreeing with the decision in *New Iberia*, held that the FDIC qualified for the federal instrumentality exception to the Tax Injunction Act. *Simon v. Cebrick*, 53 F.3d 17, 22 (CA3 1995). The Court distinguished the decisions of the First and Second Circuits in *Clark* and *New York* by finding that the governmental role of the FDIC in those cases was minimal, unlike the FDIC's role in the instant case of winding up the affairs of failed institutions pursuant to federal statutory authority. 53 F.3d at 22-23.

d. Neither the reasons for exempting the United States from the Tax Injunction Act, nor the justifications for allowing federal instrumentalities to sue on their own behalf, apply to PCAs.

The United States District Court for the Eastern District of Arkansas denied the State of Arkansas' Motion to Dismiss, holding that the Tax Injunction Act does not apply to "suits by the United States to protect itself and its instrumentalities from unconstitutional state exaction," quoting *Department of Employment v. United States*, 385 U.S. 355 (1966), a suit brought by the United States on behalf of the Red Cross. J.A. 74.

[16] 28 U.S.C. § 1345 provides for district court jurisdiction over all actions brought by the United States or by any agency or officer authorized to sue by Congress.

None of the rationales employed by federal courts for extending the exemption of the United States from the Tax Injunction Act to federal instrumentalities suing on their own behalf apply equally to PCAs. They neither occupy "a unique place in federal law,"[17] like the Indian tribes, nor has Congress granted them access to federal court statutorily.[18] To the contrary, prior to an amendment in 1975, federal court jurisdiction was prohibited to PCAs by 12 U.S.C. § 2258, which provided:

> Each institution of the System shall for the purposes of jurisdiction be deemed to be a citizen of the State, commonwealth, or District of Columbia in which its principal office is located. No district court of the United States shall have jurisdiction of any action or suit by or against any production credit association upon the ground that it was incorporated under this Act or prior Federal law, or that the United States owns any stock thereof, nor shall any district court of the United States have jurisdiction, by removal or otherwise, of any suit by or against such association except in cases by or against the United States or by or against any officer of the United States or against any person over whom the courts of the State have no jurisdiction, and except in cases by or against any receiver or conservator of any such association appointed in accordance with the provisions of this Act.

The legislative history indicates that the Governor of the Farm Credit Administration requested the amendment to allow PCAs

[17] 481 F.2d at 975

[18] See *Moe v. Confederated Salish & Kootenai Tribes*, 425 U.S. 463, 474 (1976). by contrast, Part A- Production Credit Associations of Chapter 23 of Title 12, U.S.C. §§ 2071 - 2077, contains no provision for federal court jurisdiction over PCAs.

access to federal courts to enforce liens on fishing boats called "preferred ship mortgages," jurisdiction of which was exclusively in Federal district courts under the Maritime laws. See Sen. Rep. No. 94-554, 94th Cong., 1st Sess., reprinted in 1975 U.S. Code Cong. & Admin. News 2148-2156. The effect of the amendment, as reflected in the legislative history, would be to give PCAs the same access to district court allowed to "private citizens, corporations, and other legal entities." *Id.*, at 2150.

Unlike the federal reserve banks, held to be "fiscal arms of the federal government,"[19] PCAs do not provide fiscal services to the government. PCAs' shareholders may participate in patronage dividends,[20] unlike federal reserve banks whose surplus earnings are available to the United States Treasury.[21] Other factors which the First Circuit found persuasive to confirm the governmental role of federal reserve banks were that the bank's shareholders lacked the powers and rights of shareholders of private corporations, the absence of ordinary commercial banking services provided by federal reserve banks, and their ability to make policy with the Board of Governors of the Federal Reserve System, whose members are appointed by the President.[22] Conversely, the shareholders and the members of the boards of directors of PCAs are the borrower farmers or ranchers.[23] PCAs make short term loans to their borrowers,

[19] 499 F.2d at 62.

[20] See 12 U.S.C. § 2074 (c), allowing distributions from available net earnings, on a patronage basis in stock, participation certificates, or cash.

[21] See 499 F.2d at 62.

[22] In addition to these factors, the court acknowledged that 12 U.S.C. §632, a statute providing for federal jurisdiction over federal reserve banks, weighed in favor of allowing the federal reserve banks to proceed without the United States as a party. See 499 F.2d at 62-63.

[23] See 12 U.S.C. §§ 2071, 2072, and 2073.

similar to the loans made by commercial lenders. PCAs may borrow money from the Farm Credit Bank, and may borrow from and issue notes to any commercial bank or other financial institution.[24] Although PCAs are "federal instrumentalities,"[25] their governmental role is minimal. The First Circuit, in deciding that federal reserve banks should be allowed to proceed in federal court without "the separate support of the Attorney General," explained that the court, when previously analyzing whether federal savings and loan associations were exempt from the Tax Injunction Act, "had in mind that if a sufficient threat to federal sovereignty were to arise, the Attorney General would presumably lend the umbrella of the United States, thus permitting access to the federal courts; ..." 499 F.2d at 62. Clearly the structure, function, and operation of PCAs more closely parallels that of federal savings and loan associations who were not allowed to sue on their own behalf,[26] than that of federal reserve banks, who were allowed to sue on their own behalf.[27] Several courts have considered the inability of the United States to appropriate funds to pay a tax before suing for refund, as required by most state law remedies, to be a compelling reason

[24] See 12 U.S.C. §2073 (12). Farm Credit Banks obtain their loan funds primarily through the sale of debt securities. These debt securities are not obligations of or guaranteed by the United States or any agency or instrumentality other than the Farm Credit System banks. See Farm Credit Administration 1994 Annual Report page 34.

[25] 12 U.S.C. § 2071 (a) provides, "Each production credit association shall continue as a Federally chartered instrumentality of the United States."

12 U.S.C. § 2077 provides, in relevant part, "Each production credit association and its obligations are instrumentalities of the United States..."

[26] *State Tax Commission*, 481 F.2d at 975.

[27] *Federal Reserve Bank*, 499 F.2d at 64.

for refusing to apply the bar of the Tax Injunction Act to the United States. This rationale would apply equally to a federal agency or instrumentality which relies entirely on government funds, but not to PCAs, whose funds are derived from private rather than governmental sources.[28]

Based upon the foregoing, the district court should have held that the Tax Injunction Act divested it of jurisdiction over PCAs suing on their own behalf and dismissed the case.

2. Assuming, *arguendo*, that the district court had jurisdiction, both the district court and the Circuit Court of Appeals for the Eighth Circuit erred in holding that PCAs are exempt from all taxation by the State of Arkansas.

The district court held that PCAs are exempt, as federal instrumentalities, from all state taxation, and that, in the absence of an express waiver of such exemption by Congress, they are not subject to taxation by the State of Arkansas. J.A. 73-76. In affirming the District Court decision, the Court of Appeals for the Eighth Circuit held that language in prior versions of the statute addressing taxation of PCAs, which provided additional exemptions to those contained in the present version of the statute as well as an express waiver of those additional exemptions, constituted "unnecessary surplus language" because of the implied immunity of federal instrumentalities from state taxation. J.A. 145.

a. PCAs are not sufficiently "governmental" to be entitled to the benefit of the doctrine of implied immunity of federal instrumentalities from state taxation.

The doctrine of the immunity of federal instrumentalities from

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[28] See note 24, *supra*.

state taxation arose from the opinion in *McCulloch v. Maryland*, 17 U.S. (4 Wheat) 316 (1819) written by Chief Justice Marshall. The Court's opinion construed the Supremacy Clause of the Constitution to forbid taxation of the Bank of the United States by Maryland. 17 U.S. at 436.

Decisions subsequent to *McCulloch* expanded the absolute immunity of the United States and its instrumentalities from state taxation, including interest income on federal government bonds,[29] income taxes on the wages of Federal employees,[30] and a state gross receipts tax on federal contractors.[31] This trend toward expansion of the immunity doctrine continued until this Court's decision in *James v. Dravo Contracting Co.*, 302 U.S. 134 (1937), upholding a nondiscriminatory tax on the gross proceeds received by a private contractor pursuant to a contract with the federal government.

A year after *Dravo*, this Court held that a State income tax on the income of employees of the Home Owners' Loan Corporation, a federal instrumentality, did not unconstitutionally burden the federal government. *Graves v. New York*, 306 U.S. 466, 487 (1939). Although Congress specifically exempted the Home Owners' Loan Corporation, its bonds, its franchise, capital, reserves and surplus, and its loans and income from state taxation, the statute did not either immunize or waive immunity of the salary of the corporation's employees from state taxation. The Court found no implied immunity from the tax in the silence of Congress, so long as the tax did not unconstitutionally burden the government. *Id.*

In 1982, considering the extent to which federal contractors were subject to state taxation, this Court determined that "the

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[29] See, e.g., *Weston v. City Council*, 27 U.S. (2 Pet.) 449 (1829).

[30] See e.g. *Dobbins v. Commissioners of Erie County*, 41 U.S. (16 Pet.) 435 (1842).

[31] See e.g., *Panhandle Oil Company v. Mississippi*, 277 U.S. 218 (1928).

confusing nature of our precedents" required the Court to reexamine the doctrine of federal immunity from state tax. *United States v. New Mexico*, 455 U.S. 720, 733 (1982). The Court found tax immunity appropriate only "when the levy falls on the United States itself, or on an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned." 455 U.S. at 735.

The majority of the relevant federal cases which have considered whether federal instrumentalities, rather than private parties contracting with the government, were immune from state taxation have held that the instrumentalities were immune from legally incident state taxes. In many of these decisions the instrumentality was held immune, based upon factors other than the doctrine of the implied immunity of federal instrumentalities. For example, the Red Cross was held exempt based upon the governmental nature of the instrumentality,[32] as were Federal credit unions.[33] Federal land banks were held exempt

[32] Factors such as the Red Cross' obligation to perform a wide variety of functions essential to the armed forces, its receipt of substantial material assistance from the Federal Government, and its recognized "status virtually as an arm of the Government," apparently convinced the court that the Red Cross was a tax immune instrumentality. *Department of Employment v. United States*, 385 U.S. 355, 357-358 (1966).

[33] Federal credit unions were held immune from Michigan sales taxes on their purchases following consideration of the purposes for which Federal credit unions were created, whether they continued to perform that function, and the extensive and unusual federal regulatory supervision of their creation and activities. *United States v. State of Michigan*, 851 F.2d 803,807 (CA 6 1988).

based upon a statute exempting the banks from taxation,[34] as were national banks.[35]

Although this Court has not directly addressed the implied immunity of an entity named a federal instrumentality by Congress in recent years, this Court's precedents addressing the issue in the context of private parties contracting with the federal government suggest that immunity of federal instrumentalities from state taxation will not be implied in the absence of factors which make the instrumentality "governmental." Logic dictates that applying an immunity originated in *McCulloch* to prevent "clashing sovereignty"[36] to an entity which lacks the attributes of the sovereign could result in unrestricted immunity. Requ[illegible]an entity, whether a private party or a statutorily designated federal instrumentality, to function as "an arm of the Government" or "stand in the shoes of the Government" in order to qualify for the immunity, is appropriate.

Production Credit Associations are not sufficiently governmental to be afforded the umbrella of governmental immunity from state taxation. The Federal government does not own any capital stock in any of the institutions of the Farm Credit System, including PCAs. It does not appoint any members to the boards of directors of PCAs. It does not appropriate any funds to PCAs, nor does it guarantee any of their debt. See 62 Fed.

[34] The language of 12 U.S.C. §§ 931-933 providing that Federal land banks, "including the capital and reserve or surplus therein and the income therefrom" are exempt from state taxation does not limit the exemption to allow a state to impose a sales tax on the bank's purchaser. See *Federal Land Bank v. Bismarck Lumber Co.*, 314 U.S. 95 (1941).

[35] 12 U.S.C. § 548 allows state taxation of national banks in any of four ways specified in the statute, as well as taxation of their real property. *First Agricultural National Bank v. State Tax Commission*, 392 U.S. 339, 341-342 (1968).

[36] 316 U.S. at 430.

Reg. 4429, 4435 (January 30, 1997)

b. The specific statutory immunity from state taxation originally conferred on PCAs by Congress was specifically waived when they became privately owned.

From the time of their creation, Congress expressly addressed the taxation of PCAs. Currently, 12 U.S.C. § 2077 provides:

> Each production credit association and its obligations are instrumentalities of the United States and as such any and all notes, debentures, and other obligations issued by such associations shall be exempt, both as to principal and interest, from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or any State, territorial, or local taxing authority, except that interest on such obligations shall be subject to Federal income taxation in the hands of the holder.

Upon their creation in 1933, Congress granted PCAs a broad express exemption from both Federal and state tax. The associations, their property, their franchises, capital, reserves, surplus and other funds, and their income was exempt, but not their real property. However, Congress expressly waived the exemption after the government stock was retired. See Pub.L. No. 73-98, § 63, 48 Stat. 257, 267.

The Farm Credit Act of 1971 repealed the existing farm credit legislation and rewrote the Farm Credit Act. The existing tax status of PCAs was reenacted under the PCA section of the bill (Sec. 2.17), with little change in the language of the statute other than the removal of the reference to associations other than PCAs. *See generally,* H. R. Rep. No. 593, 92d Cong., 1st Sess., reprinted in 1971 U.S. Code Cong. & Admin. News 2091, 2111. The express exemption from taxation and the waiver of exemption from taxation was preserved. Farm Credit Act of

1971, Pub. L. No. 92-181, § 2.17, 85 Stat. 583, 602 (1971).

Decisions that occurred during the period following the retirement of all PCA stock held by the Government, while not decided under current law, are indicative of the clear statutory waiver of the exemption. *See generally, Woodland Production Credit Association v. Franchise Tax Board*, 225 CA 2d 293, 37 Cal. Rptr. 231 (1964) (statutory waiver of exemption from taxation of PCAs permits taxation of the corporation itself; thus PCA is not exempt from California franchise tax which is a tax on the income of the corporation); *Columbus Production Credit Association v. Bowers*, 173 Ohio St. 97, 180 N.E.2d 1 (1962), cert. den. 371 U.S. 826 (1962) (production credit association held not exempt from Ohio franchise tax; exemption from state taxation waived by Congress in provision that exemption will not apply after the stock in the PCA held by the governor has been retired); *Baker Production Credit Association v. State Tax Commission*, 421 P.2d 984 (Ore. 1966) (each PCA became subject to state taxation when the government ownership of its stock ended).

The Farm Credit Amendments Act of 1985, Pub. L. 99-205, 99 Stat. 1678, 1705 (1985) amended much of the Farm Credit Act, in part to make the Farm Credit Administration an arm's-length regulator of the System and to remove the day-to-day participation in management. *See generally*, H. R. Rep. No. 425, 99th Cong., 1st Sess., *reprinted in* 1985 U.S. Code Cong. & Admin. News 2587. The PCA taxation statute was amended

by "striking out the last two sentences of section 2.17."[37] This amendment was included in Section 205 which "contains numerous technical and conforming amendments to the provisions of the Farm Credit Act of 1971 affected by changes in the basic powers, duties and authorities of the Farm Credit Administration," and which deletes references to the Governor of the Farm Credit Administration, which position was abolished by the amendments. H.R. Rep. No. 425, 99th Cong., 1st Sess. *reprinted in* 1985 U.S. Code Cong. & Admin. News 2587, 2615.

The 1985 amendment removed both the express exemption and the express waiver of the exemption, leaving, with only

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[37] The sentences, immediately before the amendment striking them, read:

> Such associations, their property, their franchises, capital, reserves, surplus, and other funds, and their income, shall be exempt from all taxation now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority, except that interest on the obligations of such association shall be subject only to Federal income taxation in the hands of the holder thereof pursuant to the Public Debt Act of 1941 (31 U.S.C. 742 (a)) and except any real and tangible personal property of such associations shall be subject to Federal, State, Territorial, and local taxation to the same extent as similar property is taxed. The exemption provided in the preceding sentence shall apply only for any year or part thereof in which stock in the production credit associations is held by the Governor of the Farm Credit Administration.

Pub. L. 92-181, Title II, Part B, § 2.17, 85 Stat. 602.

very minor changes, the current section 2077.[38] Although currently Section 2077 exempts the notes, debentures, and obligations issued by the PCA from state taxation, it does not confer the broad immunity from state taxation construed by both the district court and the court of appeals.

For the foregoing reasons, PCAs are not exempted from state taxation by the doctrine of implied immunity of federal instrumentalities from state taxation or by 12 U.S.C. § 2077.

CONCLUSION

The decision of the Court of Appeals for the Eighth Circuit should be vacated.

Respectfully submitted,
MARTHA G. HUNT, AR Bar No. 87090
Attorney, Revenue Legal Counsel
Arkansas Department of
Finance and Administration
Seventh and Wolfe Streets
P. O. Box 1272, Room 209
Little Rock, AR 72203
(501) 682-7030

Counsel of Record for Petitioner

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[38] An amendment in 1988 inserted a comma after "interest" and "except that interest on such obligations shall be subject to Federal income taxation in the hands of the holder" after "authority." Pub. L. 100-399, § 401 (r), 102 Stat. 998.

APPENDIX A

APPENDIX A

Ark. Code Ann. § 26-18-507 provides:

(a) Any taxpayer who has paid any state tax to the State of Arkansas, through error of fact, computation, or mistake of law, in excess of the taxes lawfully due shall, subject to the requirements of this chapter, be refunded the overpayment of the tax determined by the director to be erroneously paid upon the filing of an amended return or a verified claim for refund.

(b) The claim shall specify:

(1) The name of the taxpayer;

(2) The time when and the period for which the tax was paid;

(3) The nature and kind of tax paid;

(4) the amount of the tax which the taxpayer claimed was erroneously paid;

(5) The grounds upon which a refund is claimed; and

(6) Any other information relative to the payment as may be prescribed by the director.

(c) The director shall determine what amount of refund, if any, is due as soon as practicable after a claim has been filed, but in no event shall the taxpayer be entitled to file a suit for refund under subsection (e) of this section until at least six (6) months have elapsed from the date of the filing of the claim for refund.

(d) Notwithstanding any provisions of the law to the contrary, a taxpayer who acts only as an agent of the state in the collection of any state tax shall be entitled to claim a credit or refund of such tax only if the taxpayer establishes that he has:

(1) Borne the tax in question;

(2) Repaid the amount of the tax to the person from whom he collected it; or

(3) Obtained the consent of the person to the allow-

ance of the credit or refund.

(e) (1) The director shall make a written determination and give notice to the taxpayer concerning whether or not a refund is due. If a refund is due, the director shall certify that the claim is to be paid to the taxpayer as provided by law or credited against taxes due or to become due.

(2) (A) The taxpayer may seek judicial relief from

(i) The written decision of the director which denies the claim in whole or part; or

(ii) The director's failure to issue a written decision after the claim has been filed for six (6) months, by filing any action with the Pulaski County Chancery Court or the chancery court of the county in which the taxpayer resides or has his principal place of business after at least six (6) months have expired from the date of the filing of the claim for refund if the director has not acted on the claim, or within ninety (90) days after issuance of the director's written decision.

(B) A written decision of the director on a refund becomes final and not subject to suit ninety-one days after it is issued to the taxpayer.

APPENDIX B

APPENDIX B

26-18-406. Judicial relief.

(a) Within thirty (30) days of the issuance of the notice and demand or payment of a deficiency in tax established by a final determination of the hearing officer or the director under § 26-18-405, a taxpayer may seek judicial relief from the final determination by either:

(1) Paying under protest the amount of the deficiency, plus penalty and interest determined by the director to be due, and filing a suit to recover that amount within one (1) year from the date of payment under protest; or

(2)(A) Filing with the director a bond in double the amount of the tax deficiency due and by filing suit within thirty (30) days thereafter to stay the effect of the director's determination.

(B) The bond shall be subject to the condition that the taxpayer shall file suit within thirty (30) days after filing the bond, shall faithfully and diligently prosecute the suit to a final determination, and shall pay any deficiency found by the court to be due and any court cost assessed against him.

(C) A taxpayer's failure to file suit, diligently prosecute the suit, or pay any tax deficiency and court costs, as required by this subsection, shall result in the forfeiture of the bond in the amount of the assessment and assessed court costs.

(b)(1) Jurisdiction for a suit to contest a determination of the director shall be in the Pulaski County Chancery Court or the chancery court of the county in which the taxpayer resides or has his principal place of business, where the matter shall be tried de novo.

(2) An appeal will lie from the chancery court to the Supreme Court of Arkansas, as in other cases provided by law.

(c)(l) All taxes and penalties paid under protest shall be held by the director in a "Tax Protest Fund Account."

(2) The director shall make refunds of the taxes and penalties found by the court to be overpaid by the taxpayer from the Tax Protest Fund Account.

(3) If no suit is instituted by a taxpayer within one (1) year of the date of payment, the director shall pay the amount so held into the appropriate account as provided in § 26-18-308.

(d) The method provided in this section is the exclusive method for seeking relief from a written decision of the director establishing a deficiency in tax. No injunction shall issue to stay proceedings for assessment or collection of any taxes levied under any state tax law.

(e)(1) In any court proceeding under this section, the prevailing party may be awarded a judgment for court costs.

(2) A judgment of court costs entered by the court in favor of either party shall be treated, for purposes of this chapter, in the same manner as an overpayment or deficiency of tax, except that no interest or penalty shall be allowed or assessed with respect to any judgment for court costs.